TESTIMONY OF LG ELECRONICS USA

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Good afternoon, I'm John Toohey, Director of Strategy for LG Electronics USA. This is my seventh year at LG, and during that time I've had broad exposure to the US Home Appliance market and have played a role in LG's growth therein.

Our team is here to discuss the important characteristics of the US washer market, and the role of LG and Samsung in that market, so the ITC has the necessary information to make an informed decision. You heard a version of market reality this morning that in many ways does not match our experience.

Let's start with market characteristic #1 – washers are not a commodity product. Unlike many industrial products the Commission considers, washers are a branded consumer product. The consumer's choice among brands, designs, features and innovations has never been greater. In fact, there are a variety of washer configurations offered, and up to ten brands, with prices ranging from $300 to over $1,500 at retail. If all washers were created equal, there wouldn't be so many options available to U.S. consumers across such a broad spectrum of features and price points.

Brand is critically important, and manufacturers position their brands differently. Part of LG's strategy with regard to brand, is to develop lifelong relationships between consumers and our brand. That concept is reflected in our brand promise, "Life's Good". Under the LG brand, we market a wide range of products that appeal to consumers in different stages of their lives, starting as early as their teenage years when they may get their first LG cellphone. By the time a consumer reaches the homeowner stage of life, and is entering the market for major appliances, they already know and trust the LG brand.

This lifecycle-based strategy has contributed to LG's success over the past several years, and is expected to contribute further as more young consumers, who grew up with LG cellphones in high school and then graduated to LG TVs in their first apartment, begin to buy LG appliances in their first home. As the current slide illustrates, millennials are the fastest growing cohort in the US washer market and they continue to represent an increasing share of purchases.

Brands also serve to differentiate products. People buy different brands for different reasons. This point is made clear by the current slide, which shows the reasons consumers bought a new washer, and how those reasons differed significantly by brand. The only category where Whirlpool and GE perform higher than LG and Samsung is among consumers who bought a new washer because the "old one didn't work at all". In the more discretionary categories, such as "just wanted a new one", or "remodeled my kitchen", LG and Samsung brands significantly overperform both Whirlpool & GE. This clearly shows that the brands are differentiated in the minds of consumers.

Another way that brands are important is in how they reflect products that are new, exciting, and better meet consumer needs. Which bring us to market characteristic #2 – product innovation is critical for manufacturers to differentiate their products and drive consumer demand. LG has a rich history and is known for bringing innovation to US consumers.

This next slide showcases LG's new Twin Wash system, which is one of the most innovative concepts the washing machine industry has ever seen. This unique offering provides consumers with the ability to simultaneously wash two loads; with a big load such as a comforter in the front load washer above and a small or delicate load in the SideKick pedestal washer below. Twin Wash was one of the biggest hits at the Consumer Electronics Show last year and is now broadly available at retailers all across the US.

We also have a sample of the system here for the Commission to see. The slide shows the same sample units we have here in the hearing room. This Twin

Wash model is paired with a matching dryer and pedestal. As we will discuss later, washers and dryers are inextricably linked in the market.

As another example of innovation, LG led the market by moving the control panel to the front of the top-load washer. LG brought this innovation to market in 2012, which provided consumers with a more intuitive design, making the controls easier to see and operate. Again, we have an example here for the Commission to see. This new product immediately sold very well and became an overnight sales success. So successful, in fact that Whirlpool decided to follow this innovation with their own version in 2016.

To highlight the difference that innovation makes, we also brought a conventional top-load washer with an agitator for the Commission to see. The differences between these three washers are readily apparent, and they sell at very different price points. The agitator-type washers is the old-fashioned type that most of us our parents grew up with. It's got a moving shaft in the center of the tub that sloshes the water and clothes around.

This conventional washer is <u>not</u> what LG and Samsung sell, yet it is still a very large part of the market for Whirlpool and GE. Market characteristic # 3 is that the US washer market has a distinct lower-value segment. Notwithstanding the fact that top-load agitator models being sold today are relatively energy efficient, like other washer configurations, U.S. producers still sell this configuration. One reason for this is to establish a bright line distinction between their cheapest models and their more expensive models, in order to maintain an entry-level price point category. Another reason is to appeal to consumers with a preference for agitator-based washers. The agitator models, as you can see, look really old-fashioned, with rotary dials and white cabinets. The current slide shows that the largest segment of the U.S. market at about 38% by units is Top Load Washers With Agitators. This is the entry-level or so-called value segment because these products have the lowest price points in the market (note the ASP of $460). Also, this segment is dominated by Whirlpool with 66% share when you include the agitator models that Whirlpool makes for Sears, and GE with another 23% share. LG and Samsung do not compete at all in this value segment of the market, either through their own brand, or through OEM sales.

Consumers in the value segment are often budget constrained, and cannot afford to step-up to washers in the other two, higher-priced segments. Based on what retailers have consistently told LG, it is very difficult, if not impossible, to persuade a customer who intends to purchase a value top-load agitator washer at $450 to spend $600 dollars for a high efficiency top load washer or $750 for a front load washer. This is a clear market reality.

Our front-load and top-load washers are higher-priced across the board than U.S. produced top-load washers with agitators, and by large amounts. It is my understanding that Whirlpool is saying that any price reduction for our top-load and front load washers cascades all the way down the market, affecting prices for U.S.-produced top-load washers with agitators. This is their so-called price compression effect. I have seen no empirical support for their theory. LG has access to a database of model-specific retail prices for washers from GAP Intelligence and in our experience retail prices are representative of the invoice prices that manufacturers charge to retailers. This database identifies washers by brand, as well as by configuration.

Slide 8 shows average retail price trends for front-load washers, top-load washers without agitators, and top-load washers with agitators, for U.S. producers Whirlpool and GE, and for LG and Samsung combined. It shows the following. First, that on average LG and Samsung's retail prices for front-load and top-load washers are higher than U.S. producers' prices for top-load washers, and they have remained relatively stable.

Second, the line that shows the earliest downward trend is the line for US made non-agitator top loaders. If price compression were true, I would expect the downward trend in this line to be preceded by a downward trend in the higher-priced import models, but that is just not the case.

Third, it would be my expectation that if a price compression effect did exist, it would be stronger among models and price points that are closer to each other. Therefore, a more likely explanation for any downward trend in the agitator segment would be the decline in prices for US-made non-agitator models.

A totally separate and plausible explanation for a decline in prices of US made agitator models is provided by the fact that both Whirlpool and GE have significant volumes in that segment of the market. Therefore, there is the potential for price declines in this segment due to intra-industry competition between Whirlpool and GE. You can see in Slide 9 the price declines and close correlation in trends between top-load washers sold by each.

I will now pass the microphone over to Doug.

Good afternoon, my name is Doug Mittrucker and I've been with LG Electronics in the Home Appliances division for just over 9 ½ years. My current position is Sales Director for our Key Accounts. I spent the first 8 years of my career at LG on The Home Depot team, of which the first 5, I was assigned specifically to the laundry and dishwasher categories as a Senior Account Manager.

It is extremely misleading to think of the industry before you today as the "washer industry." From a commercial standpoint, there really is no such thing as a separate business that consists only of washing machines. All major producers of washing machines also sell dryers and pedestals. And perhaps most importantly, all washers and dryers are explicitly designed to sell together at the same price.

We have brought one laundry pairs today in order to illustrate this point. (A picture of the pair is also on the screen). As you can see, the components are designed as an integrated set that consists of a washer, a dryer, and, for front loaders, pedestals.

LG has taken the suite concept to the next level, and includes a second, entirely separate washer, the SideKick™ in the base of the pedestal. Consumers will walk into a retailer like Lowes or Home Depot, see this laundry pair on display and walk out having bought a washer a matching dryer, and if they choose a front loader, possibly a couple of pedestals.

As you can see from the next slide, Whirlpool's global director of innovation has touted their strategy of selling laundry suites. Because consumers buy them together, retailers price the washer and matching dryer the same, or as you may have noticed from this year's Black Friday ads, bundle them together at a single price.

The fact that washers and dryers are priced together would not be so important if they were sold completely separate. But they are not; they are sold together. In the industry, the metric for measuring paired laundry sales is the "attachment rate." This rate is very high: Indeed, in a sworn statement, my Whirlpool counterpart testified to attachment rates above 90 percent for at least some washers.

Besides selling two products instead of one, retailers prefer to make paired sales because it lowers their home delivery costs. That is because the third party companies that they hire to deliver and set up the appliances in your home will offer substantial discounts to the retailer on the second unit delivered.

To make merchandising and margin management simpler, retailers have forced common washer/dryer pricing onto the manufacturers. I will tell you that this is not our preferred option. Washers cost much more to make than their matching dryers. I believe that we have provided some information from our manufacturing arm in Korea to illustrate the magnitude of this cost differential. The cost difference is so large because washers weigh more than dryers, they are more complex, and their components must operate in a much harsher environment of water and heat, harsh detergents and vibration.

Therefore, because retailers require a single price point for two very different products, LG and all manufacturers have no choice but to choose a midpoint price, which is somewhere lower than the price we would like for the washer. But in exchange, we collect a higher price for the dryer. If you consider washer pricing and costs separately from the dryer, this common pricing sales phenomenon creates very high apparent profits on the dryer, and very little apparent profits on the washer.

Therefore, if you want to measure how well this or that appliance company is doing, you must look at the laundry business as a whole. This includes washers, dryers, and for front loaders, the pedestals, which is a very highly profitable accessory item. In conclusion, it makes no sense to consider washer profitability alone, because they are not priced as a stand-alone product, nor sold that way.

I will now pass the microphone back to John.

I next want to address something Whirlpool has repeated *ad nauseum*; specifically, that it was LG's low prices to retailers that accounted for our success. This is not true. In fact, a good part of LG's success over the past couple of years is attributable to our ability to gain expanded distribution within new retail accounts. I have a personal perspective on this matter because of my role at LG. In the past few years, LG has entered three new strategic retail accounts, namely Lowe's, Costco and JC Penney. I can provide specific details about each in our confidential post hearing submission; but our sales to these three retailers accounted for a substantial portion of LGs washer sales in 2016.

And I can say without qualification that LG's selling price had very little to do with the desire of these major retailers to start carrying LG washers, because I was part of the LG team that negotiated with each of them.

Let's start with **<u>Lowe's</u>**

Given Lowe's significant clout in the US appliance market, including laundry, LG approached Lowe's in 2010 to propose the idea of working together. Although Lowe's agreed to meet and listen to LG's pitch, they told us that they were not interested at that time in carrying our appliances.

About a year later, toward the end of 2011, Lowes reached out to LG, and requested a presentation on the pros and cons of Lowes starting to carry LG home appliances.

Among several points, the presentation highlighted why LG had been successful at other retailers.

From 2002 to 2011 for every retailer where LG was sold, we grew, even within retailers that were otherwise shrinking. This demonstrated that LG was doing something that grew its market share independent of our retail placement.

The argument for Lowe's to carry LG was based on LG being a growing brand that resonated with US consumers, many of whom were already part of Lowe's existing shopper traffic. We presented data that demonstrated that many of Lowe's customers were already aware of the LG brand, no doubt in part due to LG's TV's and smart phones. In fact a large proportion of LG appliance purchasers shopped at Lowe's and walked out empty handed to buy an LG product somewhere else.

That presentation concerned all major home appliances, including laundry, refrigerators and cooking. And perhaps most importantly, the issue of pricing of individual units was never part of the discussion.

A few months later, Lowe's informed LG that they had decided to start carrying LG major home appliances, that the decision to add LG was based on Lowe's strategy to deliver the best choices to consumers, and that Lowe's was impressed with LG's track record of strong product innovation. In addition, Lowe's agreed that many LG customers were leaving Lowe's empty handed, which represented significant incremental business opportunity.

Once again, the subject of pricing was never raised in the discussion of whether Lowe's would begin to carry LG. The decision to add LG was about the brand, and the potential to win more consumer business with innovative products. Of course, once the roll-out started, we ultimately had to agree on a pricing approach. But this happened only after the decision by Lowes to add LG to its lineup.

We started selling LG products in the first quarter of 2013.

I assembled all of the contemporaneous documentation concerning our discussion with Lowe's, and prepared a detailed annotation of all the documents, which can be found in Exhibit 19 of the Pre-Hearing Brief.

The next retailer is **Costco**

In late 2012 LG was approached by Costco. At that time, Costco was already selling LG TVs and Costco wanted to add the LG brand to their home appliance offerings, including refrigerators, laundry and cooking.

Costco told us that it wanted to add LG appliances due to LG's brand appeal to Costco's members from their experience with other LG products. At that time, Costco was carrying Whirlpool appliances, including washers, but they were apparently not selling well. At that time, LG decided not to pursue the Costco business opportunity because we were in the midst of trying to launch at Lowe's in Q1 2013 and needed to see how those market dynamics settled.

In mid-2014, a little more than a year after entering Lowe's, and after some internal deliberation, LG re-engaged with Costco. Costco still believed that there was a strong demographic and psychographic overlap between Costco members and LG's target home appliance consumers with respect to income level, age, and attitudes.

We started a pilot program with Costco in late 2014, mostly in California. The pilot was deemed successful, and the decision was made to roll out nationally to several hundred Costco clubs. The broader rollout was completed in Q4 2015.

Interestingly, the Costco merchandising model does not involve an in-store sales associate for appliances. The products are simply on display and it's up to the Costco shopper to "self -serve" by researching the products independently and ordering on Costco.com.

I note that, according to TraQline, LG's average selling prices for washers at Costco exceed those of Whirlpool. I also note that we were informed by Costco that LG sales surpassed Whirlpool's sales shortly after our broad rollout began.

And so, in a sense, Costco represents a natural experiment to test Whirlpool's theory. Notwithstanding the complete self-serve approach, and LG's higher retail selling prices, LG sold more laundry appliances at Costco in 2016 than Whirlpool. Obviously, something other than price to the retailer drove purchasing decisions. That something of course is consumer demand for LG's innovative products.

The third new retailer is **JC Penney.**

JC Penney contacted LG in the Spring of 2015 when I received a call from JC Penney's VP of Strategy who told me that JC Penney had decided to enter the major appliance category and were reviewing which brands they should offer. They explained that their strategy involved offering a "good better best" selection for their consumers, and that they envisioned LG as the "best" brand.

Following this phone call, LG undertook internal assessments about the attractiveness of JC Penney as a retailer. We decided to move forward with exploratory discussions. These discussions culminated in a meeting at JC Penney's headquarters to review the pros and cons.

At the meeting, JC Penney emphasized that their strategy was to offer their customers what they called the "most wanted national brands," and so they believed that LG would be a good fit given the incredible strength of the LG brand.

In the first quarter of 2016 we conducted a pilot test in 22 JC Penney stores, and then rolled out to about 500 JC Penney stores by the end of the third quarter of 2016.

Once again, the subject of pricing was not part of the initial discussions about whether JC Penney would begin to carry LG. The decision and the desire to add LG was about the brand, and the potential to win more consumer business with innovative products.

I will now pass the microphone over to Greg.